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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

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Date:

September 30, 2014

A =
CFC =
Country A =
Parent =
X =
Agency =
Country B =
Country C =
Country D =
Country E =
Country F =
Country G =
Country H =
Month Y =

Dear :

In a letter dated A, you requested rulings allowing CFC to use certain foreign statement insurance reserves in computing its taxable income on grounds that these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). Specifically, you requested permission to use: (1) the underwriting reserves and loss reserves for life and annuity contracts reported by CFC on its Country A Annual Return and (2) the underwriting reserves and loss reserves for noncancellable and guaranteed renewable accident and health contracts reported by CFC on its Country A Annual Return.

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The rulings given in this letter are based on facts and representations submitted by Parent and CFC and accompanied by a statement executed under penalty of perjury by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Facts

Parent is a publicly-traded domestic corporation that is engaged, through its subsidiaries, in various lines of business, which primarily include domestic and international reinsurance of life and annuity contracts. Parent conducts certain foreign operations through a Country A subsidiary, CFC. Parent owns X% of CFC. CFC was formed under the laws of Country A and is engaged in the business of reinsuring life insurance contracts, annuity contracts, and accident and health contracts through Country A and several branch operations located in Country B, Country C, Country D, Country E, Country F, Country G, and Country H. CFC is a controlled foreign corporation as defined in section 957.

Country A regulates any insurance business conducted in Country A through its insurance laws and regulations. A government body, the Agency, is responsible for enforcing insurance laws and regulations in Country A. An insurance company must obtain a license from the Agency to conduct an insurance business in Country A.

CFC is licensed by the Agency to reinsure persons other than related persons in Country A. CFC also reinsures risks through its various branches. CFC and its branches do not carry on any business other than the reinsurance of life insurance contracts, annuities, accident and health insurance contracts, and other similar and ancillary activities. CFC and its branches derive more than 50 percent of its aggregate net written premiums from the reinsurance of contracts (1) covering the applicable home country risks of the branches and (2) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person as defined in section 954(d)(3). CFC does not carry on non-life insurance businesses except for certain activities which are incidental to the life insurance business or which are otherwise immaterial to its insurance business. Parent has represented that CFC would be subject to tax under Subchapter L if it were a domestic corporation.

Each branch of CFC is a separate and clearly identified unit of the reinsurance business of CFC and maintains separate books and records. Each branch is authorized or licensed by the applicable insurance regulatory body for its home country to sell reinsurance to persons other than related persons as defined in section 954(d)(3). Each branch's financial position is overseen by the Agency.

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The branches and the Country A home office of CFC reinsure contracts that are regulated as life insurance and annuity contracts by the Agency. The branches and the home office also reinsure health and personal accident insurance contracts that are noncancellable or guaranteed renewable, cancellable, or are riders to a life insurance contract. CFC holds reserves with respect to such noncancellable health and personal accident insurance contracts which CFC treats as life insurance reserves. CFC does not receive premiums from any insurance contract in connection with the life or health of a resident of the United States or from a related party as defined under section 953(e)(2)(B)(ii). Each branch (with the exception of the Country C branch) derived more than 30% of its net written premiums from contracts that cover home country risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 953(d)(3). Each branch and the Country A home office conducts, with respect to contracts which cover risks other than applicable home country risks (as defined in section 953(e)(2)(B)(ii), substantially all the activities necessary for the generation of income with respect to each branch's reinsurance business, including client relationship management, negotiating terms of reinsurance contracts with clients, providing underwriting and claims management services, including technological solutions, actuarial assistance and e-underwriting tools, actuarial pricing for risk assessment, account administration, providing product development and advice on financial needs, including funding and financial products, and providing related services to clients.

As required by Country A's insurance laws and regulations for insurers engaged in the reinsurance business, CFC files an annual return and financial statements ("Annual Return") with the Agency. The Annual Return of CFC is audited by an outside accounting auditor in addition to the company's auditor. The accounting records of CFC that form the basis for preparing the Annual Return are subject to inspection by the Agency at any time. The Annual Return of CFC is made available to the public. CFC's Annual Return is used for financial purposes in addition to regulatory purposes, such as for credit rating purposes. Month Y is the official year-end for life insurance companies operating in Country A.

CFC has appointed a qualified actuary to be involved in matters prescribed by the Agency as actuarial matters, including the method of calculating reserves. The actuary must submit a written opinion to the Agency indicating whether the reserves relating to the insurance contracts prescribed by the Agency are established and maintained according to actuarial soundness. CFC is also subject to solvency requirements which require a risk-based level of regulatory capital targeting an optimal capital level over and above the prudent reserve estimate.

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To comply with Country A's insurance laws and regulations for reinsurance companies, CFC must establish and maintain certain reserves. These reserves are (1) underwriting reserves (including reserves for variable contracts) and (2) loss reserves that the branches maintain on their books for life insurance and annuity contracts. The rules for calculating these reserves are prescribed by insurance laws, regulations and other Agency guidance and are summarized below.

Underwriting reserves must be held to secure the performance of future obligations arising in the future from insurance contracts. The underwriting reserves consist of the present value of future benefits plus future expenses, minus the present value of future gross contract premiums, under current interest, mortality, morbidity, and lapse assumptions, with provision for moderate adverse deviation. This method is commonly referred to as the Gross Premium Valuation Method ("GPV"). The default basis for reporting financial information to the Agency is Country A generally accepted accounting principles, which do not prescribe a particular insurance reserve methodology. Parent represents that the GPV method is commonly used in Country A.

The branches may also hold loss reserves for outstanding claims (including claims that may have been incurred but not reported) from life insurance and annuity contracts reinsured by CFC. CFC calculates loss reserves using a combination of known reported claims plus estimates based on each branch's individual loss experience and general local country industry experience.

CFC represents that: (1) Neither CFC nor its branches carry on reinsurance business other than certain businesses which are incidental to the reinsurance of life insurance contracts, annuity contracts, and accident and health insurance contracts; (2) any difference in the methods under Country A law used to calculate the reserves related to an insurance policy issued by the branches as compared to the methods used to calculate such reserves for the same insurance policy under subchapter L (if the branches were U.S. insurance companies) would not cause a material difference in the measurement of CFC's income during the life of such policy; and (3) the foreign reserve method used to calculate the branches' underwriting reserves and loss reserves, are not contrary to the rules and principles applicable to the calculation of reserves under subchapter L, as modified by section 954(i).

Law

In general, a United States shareholder of a controlled foreign corporation ("CFC") must include in gross income its pro rata share of the CFC's Subpart F income for each year. Sec. 951(a). Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954. Sec. 952(a)(1) and (2). Section 953(a) defines the term "insurance income" to

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include any income which is attributable to issuing or reinsuring of an insurance or annuity contract, and which would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953 provides that section 953 insurance income does not include “exempt insurance income” derived by a “qualifying insurance company.” Section 953(b)(3) provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

Section 954(a)(1) defines the term “foreign base company income” to include, among other types of income, foreign personal holding company income. Section 954(c)(1) sets forth the types of income (e.g., interest and dividends) that are considered to be foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company”.

In general, section 953(e)(3) defines a “qualifying insurance company” as any controlled foreign corporation which:

(A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance or annuity contracts to persons other than related persons (within the meaning of Code section 954(d)(3)) in such home country;

(B) derives more than 50 percent of its aggregate net written premiums from the issuance by such controlled foreign corporation of contracts covering applicable home country risks of such corporation and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in Code section 954(d)(3)); and

(C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 953(e)(4) defines a “qualified insurance company branch” as a qualified business unit (within the meaning of section 989(a) of a controlled foreign corporation if:

(A) the unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons in such home country; and

(B) such CFC is a qualifying insurance company (as defined in section 953(e)(3)) as if such unit were a qualifying insurance company branch.

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Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. First, income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section 954(i)(4)). Sec. 954(i)(2)(A). Second, income received from unrelated persons and derived from investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts. Sec. 954(i)(2)(B).

Exempt contracts are defined under section 953(e)(2) to include insurance or annuity contracts issued by a qualifying insurance company in connection with the lives or health of residents of a country other than the U.S. but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3). A contract issued by a QIC or QIC branch which covers risks other than applicable home country risks is not treated as an exempt contract unless such company or branch conducts substantial activity with respect to an insurance business in its home country and performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract. Sec. 953(e)(2)(C).

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserves under Code section 954(i)(4)(B)(i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

Code section 954(i)(4)(B)(ii) was enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. The staff of the Joint Committee on Taxation explains this provision as follows:

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The provision does, however, permit a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve for such contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes. In seeking a ruling, the taxpayer is required to provide the IRS with necessary and appropriate information as to the method, interest rate, mortality and morbidity assumptions and other assumptions under the foreign reserve rules so that a comparison can be made to the reserve amount determined by applying the tax reserve method that would apply if the qualifying insurance company were subject to tax under Subchapter L of the Code (with the modifications provided under present law for purposes of these exceptions). The IRS also may issue published guidance indicating its approval.

Staff of the Joint Comm. On Taxation, Technical Explanation of the Job Creation and Worker Assistance Act of 2002 (JCX-12-02 (March 6, 2002)).

Sections 953 and 954 do not define the terms “life insurance or annuity contract” or “property, casualty, or health contract.” Section 953(e)(5) generally provides that, for purposes of sections 953 and 954, the determination of whether a contract issued by a CFC is a life insurance or annuity contract shall be made without regard to section 7702 if: (1) such contract is regulated as a life insurance or annuity contract by the corporation’s home country, and (2) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

Section 816(a) of the Internal Revenue Code (the “Code”) defines “life insurance company” as “an insurance company which is engaged in the business of issuing life insurance and annuity contracts . . . or noncancellable contracts of health and accident insurance, if—

(1) its life insurance reserves . . . , plus

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- (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, accident, or health policies not included in life insurance reserves,

comprise more than 50 percent of its total reserves”

Section 816(b)(1) defines the term “life insurance reserves” for purposes of Part I of Subchapter L of the Code as amounts:

- (A) which are computed on the basis of recognized mortality or morbidity tables and assumed rates of interest, and
- (B) which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable accident and health insurance contracts (including life insurance or annuity contracts combined with noncancellable accident and health insurance) involving, at the time with respect to which the reserve is computed, life, accident, or health contingencies.

Analysis

CFC is subject to regulation as a reinsurer of life insurance, annuities, and noncancellable accident and health contracts by Country A. CFC is licensed, authorized, and regulated by the Agency, which is the insurance regulatory body for Country A, to sell life insurance and annuity contracts to persons other than related persons (within the meaning of Code section 954(d)(3)) in Country A. CFC has represented that it derives more than 50 percent of its aggregate net written premiums from its issuance of life insurance and annuity contracts covering risks in connection with the lives or health of residents of Country A and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in Code section 954(d)(3)). Each of the branches is a qualified business unit (within the meaning of section 989(a) of CFC. Each branch is authorized or licensed by the applicable insurance regulatory body for its home country to sell reinsurance to persons other than related persons (within the meaning of section 954(d)(3) in such home country. Premiums received by the branches are treated as earned in its home country for the purpose of each home country’s tax laws. Finally, CFC is engaged in the life insurance business and would be subject to tax under Subchapter L if it was a domestic corporation. Accordingly, CFC is a QIC and the branches are qualifying insurance company branches.

The branches primarily reinsure life insurance and annuity contracts in connection with the lives and health of residents of their countries and do not reinsure risks on the lives or health of residents of the United States. With the exception of the Country C branch, each branch derives more than 30% of its net written premiums from contracts that cover home country risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Each branch performs in its home country substantial insurance business activity, and with respect to contracts which cover risks other than applicable home country risks (as defined in section 953(e)(2)(B)(ii), substantially all the activities necessary to give rise to the income generated by such contract. Therefore, life insurance and annuity contracts issued by CFC, with the exception of contracts issued by the Country C branch and the Country A home office, are exempt contracts within the meaning of section 953(e)(2).

CFC uses the GPV method to determine its underwriting and loss reserves. Because this method is a reasonable method for computing reserves, the foreign statement reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

CFC issues noncancellable and guaranteed renewable contracts and riders to life insurance contracts as part of its life insurance business. For Country A tax and insurance regulatory purposes, CFC computes the underwriting reserves and loss reserves using a methodology similar to that used to compute life insurance reserves. Therefore, the foreign statement underwriting reserves and loss reserves are also an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

Rulings

Based on the information submitted and the representations made, we rule as follows:

1. The foreign statement underwriting reserves and loss reserves, which are required by the Agency to be maintained for the reinsurance of life insurance and annuity contracts, are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) .

2. The foreign statement underwriting reserves and loss reserves for noncancellable and guaranteed renewable accident and health contracts reinsured by CFC, as required to be reported on the Country A annual return, are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

Caveats

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling. This ruling will be subject to revocation if any of the following circumstances occurs: (1) a change in the material facts on which this

ruling was based; (2) a material change in the business circumstances of CFC which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to CFC's current reserving method.

Procedural Statements

This ruling is directed only to Parent and CFC. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

Parent should attach a copy of this ruling letter to its Federal income tax return for the taxable years to which this letter applies. In accordance with the power of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Steven Musher
Associate Chief Counsel
(International)

By:

Steven D. Jensen
Senior Counsel, Branch 5
(International)